PENDER
BOND UNIVERSE FUND

## IN THE BEGINNING – ABOUT THE PENDER BOND UNIVERSE FUND

In the late summer of 2020, we look at the market for investment grade bonds and we are astounded. The Government of Canada yield curve is as low as a snake's belly. There isn't as much as a 1% yield to maturity in the sovereign curve until investors sign up for duration risk exceeding 20 years! High quality corporates are scarcely much richer, with front-end BBBs at one-handle and 30-year maturities of Canadian corporates trading close to 3%. At current levels, a small 1% increase in yield would result in a capital price decline of roughly 27% in the Canadian 30-year benchmark, or more than 25 years worth of anticipated return. Yes, we understand there are people from the government who say they will keep rates low. But this situation is hardly appetizing for current or prospective retirees who may have been planning on living off an income stream from their accumulated capital.

To confound matters further, many investment advisors and their clients live within a risk management regime which pushes them towards such low yielding alternatives. Modern portfolio theory, back-tested models, or powerful corporate-level risk managers: all of these factors and more are suggesting, even to the point of demanding, significant portfolio allocations to investment grade fixed income. What is a thinking person to do?

It was with this dilemma in mind that the Pender Bond Universe Fund was created. Hatched from the egg on January 31, 2020, the Fund intends to provide investors with a ratings compliant fixed income alternative. Our goal is to optimize risk-adjusted returns within the constraint of maintaining at least a 75% weight in Canadian dollar investment grade bonds.

Our formula for providing this result is to focus on return-for-risk within investment grade credit. We are not simply using a "greater than" sign to determine allocations to the highest nominal yields in investment grade bonds. Instead we consider spread, credit risk and duration to focus on the better parts of the investment grade curve with the strongest issuers from a valuation perspective. To this investment grade portion, we add a quarter share of high yield credit, where our prime criteria for inclusion (yield juxtaposed against default probability) is supported by long-term statistical analysis as a sweet spot in corporate credit[1].

We do not expect to appear on lists of extraordinary annual returns, nor are we able to promise an absence of volatility. But within the constraints of fixed income portfolios which are predominantly investment grade, we do aim to deliver the strongest risk-adjusted result that is reasonably available. That is our pledge to you.

**Born into Turbulence**

From the Fund's launch earlier this year, we believe it is fair to say that a lot has transpired. The market volatility during 2020 in response to the COVID-19 outbreak was one for the record books. You know you are in a full-on liquidation event when even government bond yields spike, as we saw through the panic selling of March. In that harrowing context, the Fund experienced a YTD drawdown of approximately 4% through the March lows. While hardly a catastrophic outcome, that episode, occurring early in the Fund's life serves as a useful real-world stress test of our strategy. It also highlights the approximate magnitude of risk to capital that even a defensively oriented fund such as this one may possess.

But the story to date of the Fund is also one that highlights the opportunity of active management. In mid-April, after government bond yields had collapsed to basis points, we repositioned the Fund away

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[1] *Common Factors in Corporate Bond Returns*, R. Israel, D. Palhares and S.Richardson. Journal of Investment Management 2nd Quarter 2018

from its then large weighting in Government of Canada issues towards corporate issuers. We also added, indirectly, through the Fund's position in the Pender Corporate Bond Fund, weight in deeply oversold securities that went on to stage strong recoveries such as W&T Offshore 2nd lien bonds and a number of convertible bonds from issuers with potential such as Zillow, which at the time traded cheaply versus par. The changes made in April contributed to the Fund's rebound in recent months.

**Current Positioning – Not Your Grandfather's Bond Ladder**
From time to time we will adjust the positioning of the Fund as critical market factors such as credit spreads and term premiums expand and contract. We also carefully monitor individual securities which, particularly in the corporate realm, can react to positive or negative developments in the credit profile of the issuer. The resulting product is something much more dynamic than your grandfather's bond ladder, onto which, one day per year, a five-year government bond was added to offset a maturity.

Currently, the principal holdings of the Fund are relatively short-dated high quality corporate bonds, denominated in Canadian dollars. These holdings include such Canadian domiciled issuers as Canadian Pacific and Royal Bank of Canada, but also include Maple bonds such as McDonald's Corporation and Apple.

In addition to the above, the Fund invests in wider spread high yield opportunities, which we do through a weight in our sister mandate, the Pender Corporate Bond Fund. That mandate's key holdings include a somewhat more "yieldy" mix of securities that require closer analysis and attention than the comparative fire-proof houses of issuers like McDonald's. Our general approach in this area is to own securities with very good coverage in value terms relative to the amount of debt at or above the level at which we are investing. At the moment, the top holdings of the Pender Corporate Bond Fund includes a first lien obligation of Intelsat S.A., the world's leading private satellite operator, and a short maturity convertible bond issued by SunPower, the largest distributor and installer of solar power systems for commercial and residential customers in the United States. While the prices of these bonds reflect a degree of underlying risk, we consider them to be adequately supported by business valuation and therefore see these as attractive investments.

The resulting mix is, as we view it, an attractive combination of relatively high yield to maturity of 2.41% as of July 31, combined a tight average maturity of 3.12 years. As markets develop, our goal is to stand poised to take advantage of either spread or duration opportunities should these materialize.

*Geoff Castle & Emily Wheeler*
*August 25, 2020*

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*Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the simplified prospectus before investing. The indicated rates of return are the historical annual compounded total returns including changes in net asset value and assume reinvestment of all distributions and are net of all management and administrative fees, but do not take into account sales, redemption or optional charges or income taxes payable by any security holder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated. This communication is intended for information purposes only and does not constitute an offer to buy or sell our products or services nor is it intended as investment and/or financial advice on any subject matter and is provided for your information only. Every effort has been made to ensure the accuracy of its contents. Certain of the statements made may contain forward-looking statements, which involve known and unknown risk, uncertainties and other factors which may cause the actual results, performance or achievements of the Company, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements.*

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